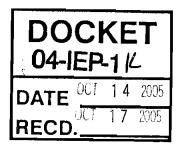
STATE OF CALIFORNIA ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION

Integrated Energy Policy Report Proceeding

Docket No. 04-IEP-1



COMMENTS OF THE UTILITY REFORM NETWORK ON THE DRAFT COMMITTEE REPORT



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In response to the California Energy Commission's draft Integrated Energy Policy Report IEPR), The Utility Reform Network (TURN) submits these comments on energy efficiency and demand response, Greenhouse Gas Performance standards, and renewable resources.

I. ENERGY EFFICIENCY AND DEMAND RESPONSE

TURN appreciates that the draft report highlights the importance of building and appliance standards, energy efficiency programs and demand response programs in reducing electric demand. TURN also strongly supports the recommendation to emphasize reductions in on-peak energy use. TURN does recommend that the draft report more clearly differentiate the differences in cost-effectiveness between demand response programs targeted towards large industrial and commercial customers versus small residential customers. In particular, while the report acknowledges that "large customers already have advanced meters that can take advantage of dynamic pricing rates," the report nevertheless concludes generally 1) that demand response programs are the most cost-effective option, 12) that an advanced metering infrastructure should be rolled-out for all customers, 23) that advanced communications "allow less intrusive and more dispatchable demand changes through two-way communications with customer thermostats," and 4) that "moving to a real-time pricing approach" will remove cross-subsidies from low use to high use customers.

These conclusions are either not substantiated, do not distinguish between customer classes or are erroneous. All three investor-owned utilities have concluded that

¹ Page 55.

² Page 61.

³ Page 62.

deploying advanced metering infrastructure for residential customers is either not cost-effective (SCE, A.05-03-026), or not cost-effective unless the utilities can capture significant operational benefits aside from demand response (SDG&E-A.05-03-015, PG&E-A.05-06-028). Utility proposals submitted to the CPUC include meters and communications; but no utility is proposing to install "smart thermostats" that could communicate with utility signals, and an evaluation of the residential Smart Thermostat pilot found that only about 50% of the participants provided reliable load response. It is not accurate to say that smart thermostat programs, with ability for customer override and day-ahead notification, are more dispatchable than, for example, direct load control air conditioner cycling programs. The allegation of cross-subsidization is not substantiated, and it is not clear whether such subsidization actually occurs under current residential inverted tier rates. Lastly, it is not at all clear that current "real-time" signals would result in different cost allocation, and certainly no utility is proposing real time rates for any customer class.

II. GREENHOUSE GAS EMISSIONS PERFORMANCE STANDARDS AND OTHER ENVIRONMENTAL EXTERNALITIES

TURN supports the recommendation for adoption of a Greenhouse Gas (GHG) performance standard and the proposal to avoid long-term investments in new coal-fired generation.⁴ In order for such a policy to have a meaningful impact on GHG emissions in the western United States, any such standard should apply to apply to all Load-Serving Entities (LSEs) including Electric Service Providers (ESPs) and Publicly Owned Utilities (POUs). Rather than limiting its focus to the procurement activities of the Investor-Owned Utilities (IOUs), the IEPR should endorse a comprehensive approach to controlling GHG emissions. Otherwise, any system will prove ineffective, create an uneven playing field between various LSEs, and merely create the appearance of progress.

⁴ Page 71.

While TURN supports the use of procurement adders as an interim solution, the ultimate policy goal should include the creation of a statewide cap-and-trade system with auctioned carbon permits. Such a system would cover all sectors (transportation, industry and electricity), thereby providing incentives for the achievement of the most cost-effective reductions in carbon emissions to meet specific and binding targets. The creation of such a system requires significant work by policymakers and stakeholders. In order to move quickly towards such a system, the state should not devote substantial time to developing a more complex framework surrounding the interim procurement adders.

For this reason, TURN warns against the creation of an offset system for use during the interim period. It is very tricky to measure and verify offsets, and there is a high potential for double counting and free riding. Moreover, there is no robust and reliable system for tracking baseline GHG emissions in California (or throughout the western US). Creation of such a tracking system should be given a high priority in the near-term so that future actions can be relied upon to meet adopted reduction goals.

As explained in the advanced coal workshops, TURN strongly believes that the Commission should lead the drive to develop a tracking system for power flows throughout the Western US in order to conclusively link environmental emissions to electricity purchases. This is particularly true given that much of the energy flowing across the border into California is "economy energy" and cannot easily be linked to a particular unit or its emissions profile. Without a tracking system, California LSEs will not be able to determine the environmental qualities of much of the power being purchased from out-of-state sources.

The CEC has been working to develop the Western Renewable Energy Geographic Information System (WREGIS) as part of its implementation of the Renewables Portfolio Standard (RPS) program. WREGIS is not currently designed to function as a comprehensive generation tracking system but could be expanded in the future to

incorporate this functionality. TURN encourages the Commission to look to the New England Power Pool Generation Information System as a possible model. The NEPool GIS tracks a variety of environmental emissions tied to individual units and kilowatt hours of production. The same should be possible for the Western United States.

III. RENEWABLE RESOURCES

TURN agrees with a number of the basic observations and some of the recommendations contained in the chapter devoted to renewable energy resources. However, this chapter dwells on perceived shortcomings of the RPS program as a justification for suggesting a variety of significant policy revisions including the creation of an unspecified "alternative RPS framework", the use of unbundled Renewable Energy Credits (RECs), less stringent compliance requirements for ESPs, and the resurrection of the incentive payment auctions run by the CEC during the late 1990s. Unfortunately, the facts do not support these recommendations, many of which would set back renewable resource development by many years and are likely to squander ratepayer money without producing measurable results.

While devoting significant space to concerns over implementation of the RPS by the CPUC, the draft IEPR fails to review the status of implementation responsibilities delegated under statute to the CEC. The final IEPR should include such a review and provide recommendations for future actions by the CEC to fulfill its responsibilities in the coming years.

A. <u>TURN agrees with the need for long-term contracts, the importance of new transmission, the establishment of contract reserve margins, and the use reasonable delivery flexibility measures</u>

(1) Need for long-term contracts

TURN agrees with the statement that the RPS program is "central to meeting California's renewable resource goals" and that the program is designed "to address the lack of long-term power purchase agreements which prevent developers from getting the financing needed to build their projects." This observation is absolutely critical and deserves to be reinforced. The draft IEPR correctly identifies the lack of long-term PPAs as a major barrier to new renewable generation. Merchant generators have consistently stated that long-term Power Purchase Agreements (PPAs) are essential to obtaining financing and moving forward with project development. The experience of other states with RPS programs suggests that the emphasis on long-term contracting under the California RPS is warranted. For example, a recent report released by the Lawrence Berkeley National Laboratory reviewing state RPS programs highlights this concern:

Lack of Credit-Worthy Long-Term Power Purchasers: As already noted, renewable energy projects generally require long-term contracts for their electrical output in order to obtain financing on reasonable terms. In regulated electricity markets, utilities can be obligated to purchase renewable energy under long-term contract. Such is the case in Nevada, California, and other states...In restructured markets, the lack of long-term contracting can be more endemic because electricity suppliers are unsure of their long-term load (and therefore renewable purchase) obligations. Even in Texas, only the utilities have been willing to enter long-term (> 10 year) contracts for renewable energy supply, with the smaller competitive electricity retailers generally content to purchase TRCs on the short-term market. In some states, this has led to predictable problems in financing renewable energy development. As noted earlier, Massachusetts provides perhaps the best example, where few suppliers have thus far been willing to enter into long-term contracts with renewable generators.

⁵ Page 89.

⁶ For example, both Calpine and IEP noted the need for long-term contracts to enable new project development during the committee hearings on the draft IEPR.

The effect has been to slow renewables development and create a tight renewables supply condition.⁷

The IEPR should retain its finding on this topic and expand upon the importance of long-term contracting as a central feature of the RPS program.

(2) Strategies for addressing inadequate transmission facilities

TURN also agrees with concerns expressed in the IEPR over inadequate transmission facilities to interconnect new renewable generation. In particular, TURN supports the focus on building new lines into the Tehachapi area to access the vast potential for windpower development in that part of the state. However, the draft IEPR incorrectly concludes that the recent rejection by FERC of Southern California Edison's "trunk line" application "removed the primary instrument the state could have used to address transmission constraints for renewables." Rather than pushing the California ISO to propose tariffs which allow for the collection of "trunk line" costs from all grid users, TURN believes that the most expedient solution is to recraft the Tehachapi expansion to create a North-South path interconnecting the PG&E and SCE systems. Such a path would presumptively provide networked benefits and thereby be eligible for rolled-in ratemaking treatment under standard FERC practice.

Another proposal of particular interest is state-funded transmission to access renewable resource areas. TURN would like to see such an approach studied to determine the potential cost savings to consumers. Construction of new transmission financed through government-issued bonds could yield significant cost reductions as compared to additions financed with private capital earning a typical FERC-approved Rate of Return.

 ⁷ "Evaluating Experience with Renewables Portfolio Standards in the United States", by Ryan Wiser,
 Kevin Porter, Robert Grace, Lawrence Berkeley National Laboratory, LBNL-54439, March 2004, p.22-23.
 ⁸ Page 98.

(3) Allowing flexible delivery, inter-utility swaps and shaped products

The IEPR suggests that the CPUC should adopt RPS program changes permitted under current law including the use of flexible delivery points, allowing shaped products and authorizing inter-utility swaps.⁹ TURN generally agrees with these suggestions and would note that the CPUC has already directed IOUs to consider purchasing power at delivery points outside their individual service territories.¹⁰ Other reasonable flexibility mechanisms should be considered so long as they do not undermine the primary emphasis on long-term contracting.

(4) Establishing a "contract risk margin" for IOU procurement

The draft IEPR suggests that, due to the risk that some renewable projects will not be successfully developed, IOUs should be required to contract for renewable energy in excess of expected future needs. The draft suggests a "contract risk margin" of 30% above an IOU's annual procurement target. TURN agrees that some projects may not be "real" and that the likelihood of future commercial operation deserves to be discounted below 100%. However, IOUs should not be discouraged from contracting with more speculative opportunities, especially if the price is attractive. The pursuit of such deals must be balanced against the need to achieve RPS targets. Given this reality, it makes sense to tie a level of excess contracting to the utilization of flexible compliance provisions. In the event that an IOU seeks to demonstrate that expected future deliveries are sufficient to justify undercompliance in the current year, the CPUC should consider adopting a "contract risk margin" to account for the risk of failure. This recommendation can be accomplished through an administrative modification of the flexible compliance rules.

⁹ Page 94.

¹⁰ See CPUC Decision 05-07-039.

¹¹ Page 94.

B. The Energy Commission has not adequately fulfilled its responsibilities under the RPS program

While devoting its focus to the RPS program activities under the jurisdiction of the CPUC, the draft report offers little insight into the status of RPS program responsibilities delegated to the CEC. This is important because, in the three years since SB 1078 was signed by Governor Davis, the CEC has not fulfilled these tasks and much work remains to be done. The draft IEPR should provide an assessment of the Energy Commission's progress along with recommendations for the next steps

Pursuant to Section 399.13 of the Public Utilities Code, the CEC has three primary responsibilities – (1) determining eligibility for renewable resources, (2) establishing a system for tracking renewable energy deliveries and verifying RPS compliance by retail sellers, and (3) awarding supplemental energy payments (SEPs). The CEC did issue guidelines on eligibility but still has significant work on the other two functions. For example, the CEC has not issued any reports verifying renewable energy deliveries for 2003 and 2004. As a result, it is still difficult to know whether the RPS compliance reports submitted by the IOUs are accurate. The Commission must be more expeditious in performing this function in order to support the CPUC in its responsibilities.

Of even greater concern is the fact that the development of WREGIS is behind schedule and is unlikely to be operational until 2007 (or later). Furthermore, the design of WREGIS may not accomplish the objective, as stated in the draft report, of determining that "energy is actually delivered" from eligible facilities.¹² Unfortunately, the WREGIS system is not currently intended to track energy deliveries although delivery of physical electricity into California is a key RPS eligibility criteria for any out-of-state resource. Despite these legal requirements governing resource eligibility and requests for this functionality from certain stakeholders, the CEC never sought to have the tracking of

actual energy flows built into WREGIS. Instead, the Commission apparently plans to build a second in-house system to track deliveries from the same resources. TURN does not understand why the CEC wants to expend additional labor and money on a second tracking system which could have been unnecessary had it asked for this functionality to be included in WREGIS.

Finally, the CEC has still not finalized any methodology for the issuance of SEPs. The absence of any specific methodology is creating significant trepidation amongst IOUs and developers about whether the SEP award process will provide the needed funds to enable projects to proceed. The CEC must complete this methodology in advance of the first application for funds or risk having to construct award metrics 'on the fly' despite years of advance notice. Consistent with the goal of creating "transparency" within the RPS program, the CEC should acknowledge the need to move quickly to finalize the SEP award metrics.

C. The draft report mischaracterizes the results of RPS procurement to date by investor-owned utilities

The draft IEPR asserts that progress under the RPS program has been minimal to date, claiming that "only a small number of contracts have been signed for renewable projects, many of which will not even begin operation until the end of 2006."¹³ While it is true that the pace of project development has not been as rapid as could have been foreseen, the draft report mischaracterizes the state of utility renewable procurement thus far.

In the solicitations ordered by the CPUC in late 2002, the results of which were credited to RPS obligations:

¹² Page 97.

¹³ Page 89.

- SDG&E executed 15 contracts for 237 MW with annual deliveries equal to ~7% of retail sales.
- SCE contracted for 200 MW from Calpine's Geysers, along with several other biomass and small hydro facilities.
- PG&E contracted for 110 MW from Calpine's Geysers and 9 MW from two other biomass plants.

Since that initial solicitation, PG&E and SDG&E entered into a series of bilateral contracts for biomass and windpower. Specifically, PG&E signed 3 contracts for 44 MW of biomass power in 2003 and another contract for an 18 MW wind repower in 2004. SDG&E executed a contract for 51 MW of new wind on tribal lands in 2004.

In the latest round of solicitations conducted during 2003 and 2004, the IOUs have begun to execute significant quantities of long-term contracts for new capacity. SCE contracted with wind, solar, biomass and geothermal projects for as much as 1300 MW of new capacity including up to 850 MW of solar thermal. PG&E contracted for 233 MW of wind and has just announced another two contracts for 18 MW of biomass. In its first round of results from the solicitation, SDG&E contracted for 300-900 MW of solar thermal and almost 20 MW of landfill gas. Taken together, contracts announced in 2005 represent far more renewable capacity (greater than 2,450 MW) than were at issue in the multi-year litigation over the ill-fated BRPU solicitation. Meanwhile, all three IOUs are conducting new RFOs this fall and expect to run another round of solicitations in 2006.

Although the draft IEPR correctly states that few projects will begin operations prior to the end of 2006, it is widely understood that new generation projects always take some time to come online. Moreover, the CPUC order directing IOUs to conduct interim renewable energy solicitations in 2002 required preferences for existing resources. It is also worth noting that many of the new gas-fired plants recently approved by the

¹⁴ The breakdown for this figure is as follows -- Biomass (12.5-37.5 MW), wind (121-345 MW), geothermal (30-120 MW), solar thermal (500-850).

CPUC are not yet online. For example, neither Mountainview (approved 2003) nor Palomar (approved 2004) will be operational until the summer of 2006, and these plants both were in advanced stages of development (CEC permits, major equipment ordered, EPC contracts finished, and site control) at the time of contract execution.

D. <u>TURN shares the concern over the lack of procurement to date by Publicly</u> Owned Utilities and Electric Service Providers

TURN shares the concern that RPS progress has been disproportionately limited to the IOUs and "the shortfall appears to be from non-IOU retail sellers such as POUs, ESPs and CCAs." The draft IEPR is correct in asserting that more attention should be focused on ESPs and POUs and in concluding that such entities should be required to meet comparable RPS targets. There is a pressing need for the CPUC to develop RPS compliance rules for CCAs and ESPs. TURN has been urging the CPUC to promulgate such rules since the first round of implementation proceedings in 2003. Only in the second half of 2005 has the CPUC expressed any inkling of interest in actually tackling this difficult task.

TURN urges the draft IEPR to expand its support for the use of a procurement agent as a structure for executing long-term contracts with renewable suppliers on behalf of direct access customers. Absent such a structure, TURN is very concerned that no long-term contracting will be done for this sizable segment of the market. Without long-term contracting, it is hard to understand how new resources can be build to serve these customers.

¹⁵ Page 95.

¹⁶ There is no need to lament the lack of progress by Community Choice Aggregators, since no such entities exist at this time in California.

E. Data transparency within the RPS program

The IEPR draft identifies the lack of transparency as a major problem with the existing RPS program. TURN agrees that there is too much confidentiality and has worked with the CPUC and IOUs to increase the amount of information publicly disclosed. For example, TURN's work in the past year led to the new IOU practice of disclosing substantial public information about individual renewable projects in the advice letters submitted to the CPUC seeking contract approval. There is room for additional public disclosure and TURN plans to press for greater transparency as appropriate.

But TURN disagrees with the proposition that all information, including bid prices submitted by developers and all final contract prices, should be made public. Transparent pricing, coupled with inflexible and escalating demand for renewable power, could result in price manipulation, gaming and higher costs. Rather than releasing too much information to the companies seeking to profit from the RPS program, TURN supports and incremental approach to disclosure.

It is worth noting that CEC staff has access to the same confidential materials available to TURN. CEC Commissioners can also review these confidential materials but, thus far, have decided to refrain from gaining access. Therefore, there is no clear reason why full public disclosure is necessary to allow the CEC to take all relevant information into account as part of its deliberative processes.

F. Is the RPS too administratively complex?

The draft IEPR laments the administrative complexity of the RPS program.¹⁷ While this observation is accurate, the report must recognize the other related truth – all electric procurement is extremely complicated. There is no way to make it simple. The RPS program takes many complicated decision processes and makes them transparent by

subjecting the evaluation methodologies used by the IOUs to public review and CPUC approval. The alternative approach is to leave the evaluation, selection and contracting process to the whims of each utility. Absent the requirement for public review and CPUC approval, the IOUs would simply invent their methodologies, their own contract terms, and their own preferred solicitation protocols. Leaving it to the utilities to unilaterally decide these elements of the program could have perverse results and undermine the goal of ensuring fair, transparent, and open competition amongst the sellers of renewable power.

Although the complexity means that the initial rollout of the RPS program has been slower than expected, the basic structures are now in place and the cycles of procurement activity are becoming more standardized. The up-front work is therefore likely to pay off with accelerated utility procurement under rules which have been subjected to substantial scrutiny by all stakeholders.

In the coming years, the CEC and CPUC should be looking for ways to eliminate unnecessary complexity or duplicative administrative processes. TURN supports all reasonable streamlining which would help achieve the RPS goals with the least burden on regulators, utilities and other interested stakeholders.

G. The draft report fails to provide a realistic and balanced assessment of the potential role of unbundled Renewable Energy Credits

While expressing concern over the need for progress in applying the RPS to ESPs and CCAs, the draft report claims that rules governing IOUs "such as calling for electricity delivery, long-term contracts, and procurement oversight by the CPUC, do not fit typical ESP and CCA business models."18 Based on this assumption, the draft report calls for tradable Rnewable Energy Credits (RECs) to be allowed in order to "reduce the

¹⁷ Page 94. ¹⁸ Page 96.

need for new transmission lines, relieve transmission congestion, and help meet renewable energy goals."

TURN strongly opposes the loosening of procurement rules for ESPs and the introduction of tradable RECs until it can be demonstrated that these activities will result in the development of new renewable generation infrastructure. Based on our observations, the promises made for tradable RECs simply do not match the reality – the use of RECs will not reduce the need for new transmission infrastructure to interconnect generation to the grid, and there is no evidence that it will reduce congestion on already overloaded lines (especially in light of the recently adopted "delivery flexibility" at the CPUC). Generators still need to deliver electricity to the ISO or a load-serving entity. To the extent that transmission constraints prevent delivery of energy to major load centers, the solution is to physically upgrade the transmission system. RECs cannot remedy the problem of inadequate infrastructure.

Most importantly, there is no evidence that purchases of unbundled RECs, even on a long-term basis, will provide sufficient assurances to enable project financing. TURN is concerned that reliance on unbundled RECs and the use of short-term contracting would create the false illusion of progress while precipitating a renewable supply crisis. The Commission should ask itself a simple question – what entity will supply these RECs to ESPs? The answer is existing facilities not currently selling output under a long-term contract. Once the supply of existing resources is consumed, escalating demands by retailers relying on RECs and short-term arrangements could lead to price escalation and a REC market meltdown. If REC prices trend towards the current penalty cap (5 cents/kwh), as has happened in the New England markets, wholesale buyers will begin to rebel against renewable energy purchase obligations. High REC prices and widespread noncompliance will not serve the long-term interests of the RPS program and could instead lead to the demise of renewable procurement obligations in California.

The goal of the RPS policy must be to ensure continual additions of new capacity and advanced planning coupled with long-term commitments by creditworthy buyers. The draft report should be modified to reflect this reality and propose solutions which will help to solve, and not exacerbate, the hurdles to new project development.

H. Renewable procurement goals should not be achieved through a reliance on all-source solicitations and an elimination of the Market Price Referent benchmark

The draft IEPR suggests that possible desirable revisions to the RPS program involve combining renewable and all-source procurement and eliminating both the Market Price Referent and SEP awards.¹⁹ TURN opposes these changes for a variety of reasons, not the least of which is the unwelcome distractions it creates while IOUs are in the midst of active procurement using dedicated solicitations. Focusing time and attention on switching to all-source procurement and removing the MPR-SEP structure will only delay progress towards reaching the 20% target.

TURN also cautions the Commission against the notion that switching to all-source procurement will produce superior results. Based on experience reviewing recent all source RFOs, TURN believes that these solicitations are not likely to be effective vehicles for the selection of renewable resources. The metrics for comparing gas-fired resources with renewables are very tricky, and the two sets of resources serve different purposes in the IOU portfolios. Some of the benefits of fossil units (ramping, load-following, ancillary services) are not available from renewables. Also, the RPS creates a very specific need for renewables which could not be satisfied by fossil units as part of an all-source process. Currently, IOUs do not conduct all-source RFOs for long-term capacity and energy on an annual basis. Retaining dedicated, regular solicitations limited to renewable projects is critical to progress on the RPS program.

TURN opposes the elimination of the MRP and SEP structure on the grounds that that such a change would seriously undermine needed cost controls. TURN supports the achievement of a 20% renewable portfolio, and even a 33% portfolio by 2020, but not at any cost. The MPR/SEP mechanism should provide a measure of cost containment and ensure that PGC funds collected from ratepayers are efficiently spent to support the development of renewable resources used to meet the RPS targets. The current structure can, and should, be refined over time. But there is no benefit to its elimination at this juncture.

I. Returning to a system of auctioned financial awards would squander ratepayer money and fail to produce new infrastructure

Perhaps the most perplexing and disturbing recommendation in this chapter is the possible return to the SB90-style auction process used to award production incentives during the late 1990s. Citing support from "several stakeholders" and the "simplicity and success" of these past auctions, the draft IEPR opines on the potential revival of this approach.²⁰

These past auctions should not be viewed as an effort worthy of repetition. Although the CEC previously announced incentive awards for over 1300 MW of new renewable capacity, the vast majority of these megawatts were never built and most of the money went unspent. It is hard to understand how the CEC could propose a return to an auction system which proved, at best, to be an underachieving policy approach.

Auctioning off incentive awards makes little sense unless the bidder is simultaneously aware of the other revenues it will receive over the life of the project and has long-term assurances which offer sufficient security to investors. Providing an opportunity to bid for incentives in a vacuum would only result in speculative bidding, tie up PGC funds

¹⁹ Page 93.

²⁰ Page 94.

for many projects which have little chance of being built, and cause ratepayer money to be squandered. There is no indication that a return to this system would be efficiently coordinated with long-term contracting activities or yield lower overall prices for ratepayers.

Respectfully submitted,

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